

**STATUS REPORT  
ON THE NATIONAL HOUSING POLICY PROJECT  
FOR KYRGYZSTAN**

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Shelter Sector Reform Project for  
the Newly Independent States of the Former Soviet Union**

## ABSTRACT

In July, 1995 the Government of Kyrgyzstan (GOK) issued a decree authorizing the establishment of an Inter-Ministerial Housing Policy Council to propose policies, legislation and programs to implement market reform of the housing sector in Kyrgyzstan. ICMA has been working closely with the GOK to develop and implement an action plan for housing sector reform. Technical assistance for housing sector reform has been organized into three phases. The first was a U.S. study tour in August, 1995, by some of the key people who will be preparing housing sector reform proposals. The second phase was a National Housing Policy conference jointly sponsored by the GOK and ICMA, which was held in September, 1995. The third phase is the work of the Council and the subcommittees organized under the council to prepare proposals for housing sector reform.

The purpose of the consultant's visit to Kazakhstan from November 12 through November 16, 1995, was to begin the initial work on the third phase of technical assistance for housing sector policy reform. The consultant met with the housing policy reform subcommittees to help organize a work plan for each subcommittee, define each committee's goals and objectives and identify areas where specific technical assistance could support the committee's efforts. Meetings also were held with USAID banking and fiscal reform advisors to coordinate housing sector reform efforts with the overall economic, fiscal and financial reform program for Kyrgyzstan.

## EXECUTIVE SUMMARY

### A. BACKGROUND

The government of Kyrgyzstan (GOK), with the support of ICMA/Kyrgyzstan, has made sound progress towards the formulation of a policy framework for reform of the housing sector in Kyrgyzstan. In July, 1995, the GOK issued a decree creating an Inter-Ministerial Housing Policy Council ("the Council") to propose housing sector reform initiatives to the GOK. In August, 1995, representatives of the ministries and agencies who will be involved in formulating the housing sector reform proposals visited the United States. In September, 1995, a National Housing Policy Conference was held in Kyrgyzstan. The report of the September 1995, National Housing Policy Conference defined the consensus housing sector reform policy objectives. The priorities for action were legal and institutional reform, provision of communal services and mobilization of internal and external funds for housing.

Based on the recommendation of ICMA, the Council established five subcommittees to focus on specific aspects of housing sector reform. These subcommittees are:

1. Legal and institutional reform
2. Urban infrastructure and municipal reform
3. Construction industry reform
4. Public housing and communal services reform
5. Housing finance and fiscal reform

The organizational meetings of these subcommittees were held during the consultant's visit to Kyrgyzstan from November 12 to 16, 1995. Meetings also were held with USAID banking reform and fiscal advisors, a group of Kyrgyz bankers and with the Chief Architect of the City of Bishkek.

### B. SUMMARY AND CONCLUSIONS

#### 1. Action Plan for Housing Policy Reform

The goal of the Housing Policy Reform Project is to have draft proposals for the highest priority reform initiatives before the GOK by the summer of 1996. Initially, a group of experts will prepare a brief housing policy position paper which, it is hoped, will gain a strong Presidential endorsement after the December elections. ICMA will support the initial work of the five subcommittees formed by the Inter-Ministerial Council by compiling a housing policy briefing manual containing summaries of key issues and appropriate examples of proposals, laws and regulations from other countries, particularly from countries in the CIS and Central Europe which share similar legal and institutional structures with Kyrgyzstan. The subcommittees are scheduled to meet in January to begin substantive work.

#### 2. Coordination with Other Economic Reform Programs

Coordination with other USAID reform programs will be essential to the success of the housing sector reform project. Fiscal and financial sector reform are closely related to housing sector reform. Any proposals to provide incentives for investment in housing should

be consistent with broader fiscal and financial reform objectives.

### 3. Immediate Action Priorities

With ICMA's assistance, the Council has defined the objectives of housing sector policy reform. Two initiatives which have a high priority are:

- a. Elimination or substantial reduction of the 10% tax on the transfer of interests in real property; and
- b. Enactment of a mortgage law and related amendments to the Civil Code.

### 4. City of Bishkek

The City of Bishkek has played a leadership role in several areas, notably the successful competitive auction of government-owned real property. Recently, the City joined with other organizations to establish a Bank - the Bishkek Bank- to be the city's fiscal agent and to mobilize resources to finance projects in the city.

## C. ORGANIZATIONAL STRUCTURE OF THE INTER-MINISTERIAL HOUSING POLICY COUNCIL

Initially, there was some question about the usefulness of the subcommittee form of organization for the housing policy reform effort. Traditionally, a small group of experts have drafted proposals which were then circulated for comment. By the end of the consultant's visit, there appeared to be consensus that the subcommittee organization would be workable and would provide a means for the various groups which will be affected by future housing reforms to have input into the reform process.

ICMA will provide technical assistance to the subcommittees in several areas:

1. Compilation of representative proposals, programs and documents from CIS, Central European and developing countries as models for consideration;
2. Coordination of the work of the subcommittees;
3. Technical support (e.g. research, translation, production, printing) to the subcommittees and the Council;
4. Technical advisors for the individual subcommittees and the Council.

Subsequent to the consultant's visit, the Council requested ICMA technical assistance to draft a brief housing policy statement outlining the GOK's goals and objectives for housing sector reform.

## D. COORDINATION WITH OTHER REFORM EFFORTS

Discussions were held with U.S. Treasury fiscal reform advisor, Ilena Casto, and USAID banking reform advisor Isaak Svartsman to identify areas of housing sector reform which will require close coordination with fiscal and financial sector reform efforts. Of particular concern was whether proposals for tax incentives for housing could conflict with fiscal reform. At the time of the consultant's visit, tax reform legislation was before the government. Several provisions of these tax bills could affect the housing sector.

Another tax issue was the transfer tax for conveyancing real property. The current tax

on property transfers is a major impediment to the development of the real estate and housing finance markets. A high priority for housing sector reform would be the abolishment or significant reduction in the transfer tax. Fiscal advisors have considered maintaining the transfer tax as a source of revenue for local governments.

There are several areas of common concern between financial sector reform and housing sector reform. These are:

1. Clarification of property rights, including the possibility of title insurance;
2. Passage of a mortgage law;
3. Clear legal definition of the rights of secured creditors;
4. Facilitating the disposition of foreclosed real estate;

The National Bank of Kyrgyzstan (NBK) and its USAID advisors currently are working on a mortgage law for Kyrgyzstan. A separate group working on commercial law also has begun work in this area. ICMA will coordinate the work on a mortgage law with the NBK and USAID advisors.

#### E. HOUSING FINANCE

A meeting was organized with over twenty representatives of Kyrgyz banks to determine their interest in housing finance, what they perceived as some of the main impediments to development of the sector and their interest in training. The NBK and thirteen commercial banks sent representatives to the meeting. The participants expressed interest in training and technical assistance in housing finance. The participants said that some of the roadblocks to a housing finance market were the lack of a mortgage law and reliable procedures to realize on collateral, the tax on the transfer of interests in real property, including mortgages, limited affordability of mortgage credit at current high interest rates and low household incomes and the lack of sources of funding for longer term housing loans.

Passage of a mortgage law has been given the highest priority for development of the housing finance market, not only because it will enable mortgagees to realize on houses pledged as collateral for loans, but because the National Bank of the Kyrgyz Republic (NBK) will not grant home mortgages a more favorable risk weight in the risk-adjusted capital standard until a mortgage law and related amendments to the Civil Code are enacted. The international bank capital adequacy regulation assesses the credit risk of home mortgages at 50% instead of the 100% risk weighting assigned to other consumer and commercial credits. In other words, a bank is required to maintain only half as much capital to support a portfolio of home mortgage loans as would be required for a portfolio of commercial loans. This preference has been a powerful incentive for banks in developed and developing countries to enter the home mortgage market or increase their volume of mortgage lending.

#### F. CITY OF BISHKEK

\_\_\_\_\_ The City of Bishkek has assumed a leadership role in several areas of housing sector reform. With ICMA assistance, the city has held three successful sealed bid auctions of government-owned property. Bishkek's auction program is becoming a model for other local governments in Kyrgyzstan. The Chief Architect of the City of Bishkek, Tolobay Keneshov, is eager to institute additional reforms. His primary concerns are the disposition of unfinished

construction, development of the “zones of individual construction” located on the outskirts of the city and implementing fees for municipal services.

The Chief Architect expressed his interest in participating in the United Nations Habitat conference to be held in Turkey in June, 1996. He requested USAID assistance to construct a display booth and prepare informational materials to promote foreign capital investment in Bishkek.

The Chief Architect recognizes that the lack of sufficient financial resources is one of the primary impediments to market reform. One effort the city has undertaken to address this issue has been participation in the founding of a new bank - the Bishkek Bank - which was authorized by the NBK in October, 1995. The city has provided space for the bank's headquarters. One of the primary functions of Bishkek Bank will be to act as the fiscal agent for the city. The city will place all of its deposits in the bank and will use the bank as its paying and transfer agent. All fees and other revenues collected by the city, including fees for public utilities, will be paid into the bank. Bishkek Bank hopes to serve as the apex institution for programs and projects in the City of Bishkek.

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FOR KYRGYZSTAN

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## STATUS REPORT ON THE NATIONAL HOUSING POLICY PROJECT FOR KYRGYZSTAN

### A. BACKGROUND AND PURPOSE

The government of Kyrgyzstan (GOK), with the support of ICMA/Kyrgyzstan, has made sound progress towards the formulation of a policy framework for reform of the housing sector in Kyrgyzstan. In July, 1995, the GOK issued a decree creating an Inter-Ministerial Housing Policy Council ("the Council") to propose housing sector reform initiatives to the GOK. In August, 1995, representatives of the ministries and agencies who will be involved in formulating the housing sector reform proposals visited the United States. In September, 1995, a National Housing Policy Conference was held in Kyrgyzstan. The report of the September 1995, National Housing Policy Conference defined the consensus housing sector reform policy objectives. The priorities for action were legal and institutional reform, provision of communal services and mobilization of internal and external funds for housing. A summary of the housing policy goals and objectives developed by ICMA based on the consensus of the delegates to the National Housing Policy Conference is attached as Annex A of this report.

Based on the recommendation of ICMA, the Council established five subcommittees to focus on specific aspects of housing sector reform. These subcommittees are:

1. Legal and institutional reform
2. Urban infrastructure and municipal reform
3. Construction industry reform
4. Public housing and communal services reform
5. Housing finance and fiscal reform

ICMA's summary of the objectives of these five subcommittees is included in Annex A.

The organizational meetings of these subcommittees were held during the consultant's visit to Kyrgyzstan from November 12 to 16, 1995. Meetings also were held with USAID banking reform and fiscal advisors, a group of Kyrgyz bankers and with the Chief Architect of the City of Bishkek.

### B. SUMMARY AND CONCLUSIONS

#### 1. Action Plan for Housing Policy Reform

\_\_\_\_\_ The goal of the Housing Policy Reform Project is to have draft proposals for the highest priority reform initiatives before the GOK by the summer of 1996. Initially, a group of experts will prepare a brief housing policy position paper which, it is hoped, will gain a strong Presidential endorsement after the December elections. ICMA will support the initial

work of the five subcommittees formed by the Inter-Ministerial Council by compiling a housing policy briefing manual containing summaries of key issues and appropriate examples of proposals, laws and regulations from other countries, particularly from countries in the CIS and

Central Europe which share similar legal and institutional structures with Kyrgyzstan. The subcommittees are scheduled to meet in January to begin substantive work.

2. Coordination with Other Economic Reform Programs

Coordination with other USAID reform programs will be essential to the success of the housing sector reform project. Fiscal and financial sector reform are closely related to housing sector reform. Any proposals to provide incentives for investment in housing should be consistent with broader fiscal and financial reform objectives.

3. Immediate Action Priorities

With ICMA's assistance, the Council has defined the objectives of housing sector policy reform. Two initiatives which have a high priority are:

- a. Elimination or substantial reduction of the 10% tax on the transfer of interests in real property; and
- b. Enactment of a mortgage law and related amendments to the Civil Code.

4. City of Bishkek

The City of Bishkek has played a leadership role in several areas, notably the successful competitive auction of government-owned real property. Recently, the City joined with other organizations to establish a Bank - the Bishkek Bank- to be the city's fiscal agent and to mobilize resources to finance projects in the city.

C. ORGANIZATION OF THE HOUSING SECTOR POLICY REFORM PROJECT

The initial meetings of the five subcommittees organized by the Inter-Ministerial Housing Policy Council were held during the consultant's visit to Bishkek, November 12 to 16, 1995. Some of the meetings were sparsely attended and there was some uncertainty among those people who did attend about what their role would be. Most of the discussion with the subcommittee members who did attend the meetings was devoted to organizational issues. There was limited substantive discussion of housing sector policy issues.

Representatives of GOSSTROI initially objected to the subcommittee structure and expressed their preference for the traditional process in which a small group of experts would draft the housing policy proposals and seek formal comments only after the proposals had been completed. Inter-ministerial cooperation and interaction for policy formulation has not been the standard practice in Kyrgyzstan. GOSSTROI officials also were skeptical that people would serve on the subcommittees without compensation. After further discussion with ICMA, GOSSTROI agreed that the subcommittees could provide valuable input to the decision-making process and that there would be some benefit to arriving at consensus before drafts of laws, regulations and policy statements would be finalized. Therefore, the Council will proceed with the subcommittee structure. The next subcommittee meetings will be held in January, 1996, after the December elections in Kyrgyzstan and the return of Resident Advisor Duane Beard and consultant Ron MacLaughlin from the U.S.

It was determined that ICMA could expedite the work of the subcommittees if it compiled and distributed a briefing manual which would highlight the key issues which must

be addressed and provide appropriate examples of proposals, laws, regulations and other documents from CIS countries, Central Europe, the U.S. and other countries. The Kyrgyz already have gathered some materials from Kazakhstan and Russia and representatives from these two countries contributed written materials at the September National Housing Policy Conference.

Subsequent to the consultant's trip, the Council requested ICMA assistance in drafting a brief housing sector policy position paper. The December elections in Kyrgyzstan could provide an opportunity for a well formulated housing policy statement to gain strong Presidential support. If housing sector reform is given a high priority by the GOK, the Council and subcommittee members would have a greater incentive to commit the time and effort required to complete their work in a timely fashion.

#### D. COORDINATION WITH USAID-SPONSORED FISCAL AND FINANCIAL SECTOR REFORM PROJECTS

##### 1. Fiscal Reform Program

Reform of the housing sector may involve proposals for tax preferences for housing savings and investment, abolition or reduction of existing taxes and deductibility of mortgage interest. Virtually every country grants some form of preferential treatment to housing. The objectives of such preferences are to stimulate investment in the sector and make housing more affordable. It will be critical for ICMA to coordinate any proposals for tax and other financial incentives which may be recommended for housing with the U.S. advisors working on fiscal reform. This issue was discussed with USAID Representative for Kyrgyzstan, C.J. Bell. Ms. Bell agreed that it would be important to coordinate various reform initiatives and said that she would facilitate the process.

In November, two tax laws were before the GOK, the law on taxation of individuals and the law on taxation of corporate profits. The proposed personal income tax law does not include any deduction for mortgage interest, a tax incentive for housing investment widely used in the developed and developing world. The proposed law does grant an exemption from capital gains taxes on the sale of a person's home up to a specified maximum amount.

The corporate profits tax law appears to permit companies to deduct housing allowances or other housing benefits granted to employees. Article 8 of the proposed law permits companies to deduct the "amount granted as material and social benefits of employees" from their aggregate annual income in computing taxable income. However, in Article 9, the proposed law does not allow a deduction for "expenses related to the construction, operation and maintenance of objects not used in the business activities and other expenses not related to the business." ICMA should consult with U.S. fiscal reform advisors to determine what tax benefits for housing are included in the pending tax laws and what further incentives would be acceptable.

##### 2. Property Transfer Taxes

The taxes levied on transfers of interests in real property constitute a major impediment to the development of the housing sector. A tax equal to 10% of the value of the transaction is assessed each time property is conveyed, including the registration of a mortgage on real

property. This tax is in addition to the fees charged by notaries to register a conveyance. It was not certain which governmental body assessed the transfer tax: the local administration, the Ministry of Justice or another governmental body. The transfer tax not only raises the cost of a real estate transaction, it is an incentive to the parties to understate the value of the transaction and contributes to price distortion in the market. The transfer tax has even more serious implications for mortgage finance. When a home purchaser buys a house and finances it with a mortgage, he/she would be required to pay 10% of the purchase price to transfer title to the property and an additional 10% of the amount of the mortgage to assign a security interest in the property to the mortgagee.

It is strongly recommended that the GOK adopt legislation which abolishes the transfer tax or reduces it to a reasonable level which would not interfere with the operation of the market. Such legislation should be given a high priority. The potential negative revenue impact on the governmental entity which currently is collecting the tax must be evaluated and an alternative revenue source, such as a property tax, created. It is possible, however, that while revenues may fall in the short run, the long run fiscal impact could be neutral or even positive. As the real estate and mortgage markets develop in Kyrgyzstan the volume of transactions can be expected to increase substantially. If the law requires that all transactions involving the transfer of property rights be subject to a transfer tax and establishes a low tax rate, the volume of transactions in which the tax is actually paid may increase to the point where the impact is revenue neutral or even revenue producing.

### 3. Financial Sector Reform

Reform of the financial sector and strengthening the banking system are critical to overall economic reform in Kyrgyzstan, as well as the housing sector. Financial resources must be mobilized through the banking system to provide a source of funds for housing finance and investment. The highest housing-related priorities for financial sector reform are:

- Passage of a mortgage law and related amendments to the Civil Code;
- Stimulating growth in savings; and
- Institutional development.

a. Mortgage Law: Enactment of an effective mortgage law is part of a larger effort to define the rights of debtors and creditors in secured financial transactions. The ability of a creditor to foreclose on real property pledged as security for a loan, take possession of the property and sell it to recover the principal and interest due is the linchpin of a housing finance system. Banks are not willing to lend on the security of real estate unless they have assurance that they can realize on the collateral pledged within a reasonable amount of time and at a reasonable cost. In addition, the National Bank of the Kyrgyz Republic (NBK) "Instruction on the Definition of Capital Adequacy Standards of Commercial Banks of the Kyrgyz Republic" (NBK Resolution #12/1 of June 4, 1995), which adopted the BIS capital requirements, made the preferential 50% risk weighting for home mortgages contingent on amendment of the Civil Code to permit effective foreclosure and sale of mortgaged property. Section 4.1.3 of the NBK Instruction states:

#### 4.1.3 Category 3 - credit risk - 50%

Loans to private persons for purchasing and constructing dwellings for one family

and guaranteed by mortgages for such dwellings with a loan to value ratio of not more than 60 percent. Loans which are past-due more than 60 days which have either suspended interest accruals or been renegotiated are not eligible for inclusion in this category. Loans for the construction of dwellings for one family are qualified only if they are given to the persons who are going to live in the dwellings.\*

\* This category is to be valid only after making changes in the Civil Code relating to the right of selling and buying land as private property and the possibility of taking the mortgaged dwelling. Hence, before adopting changes in the Civil Code, all loans should be evaluated as 100% risk grade.

b. **Savings Mobilization:** Savings mobilization is critical to the development of a housing finance market in Kyrgyzstan. Bank deposits have been growing, but much of the financial resources of the country remain outside the banking system. The NBK reported that as of June 30, 1995, bank deposits totaled 3 billion soms (about \$270 million), an increase of 14.4% over December 31, 1994. The rate of growth in household and commercial deposits was substantially higher than overall deposit growth. Household deposits increased by 31.5% and commercial deposits by 68.3% over the first six months of 1995, despite a sharp decline in deposit interest rates during the same period. The growth in deposits indicates increasing public trust in the banking system and a rising propensity to save. However, the amount of deposits held remains too low to finance any significant new lending programs. Household and commercial deposits totaled less than \$25 million at the end of June, 1995.

Mobilizing savings for housing will be a difficult task in Kyrgyzstan because of the low level of personal income, higher yielding alternative investments and general lack of confidence in the financial system. It is likely that it will be necessary to offer tax and other financial incentives to attract any meaningful amount of financial resources to the housing sector. Such incentives may not be consistent with the goals of fiscal and financial sector reform.

c. **Institutional Development:** Even if funds become more readily available, the weak financial and managerial condition of most Kyrgyz banks may preclude their entry into the housing finance market. The banks must increase their profitability to build the capital needed to support future growth. The yield on mortgage loans will generally be lower than the yield on commercial credits unless the GOK provides interest rate subsidies or buy downs and/or interest on mortgages is granted preferential tax treatment. The banks also lack the skills and expertise required to manage a real estate financing function. Training in real estate finance would be required before bank management and staff would be prepared to launch new real estate loan departments.

The consultant met with over twenty representatives from the NBK and thirteen Kyrgyz banks to discuss the banking sector's interest in housing finance and the principal impediments to developing the housing finance market. The affordability of housing and mortgage finance in light of low household income and high interest rates was viewed as a major problem. Interest rates in Kyrgyzstan are falling and may reach a level where mortgage lending may be more feasible. However, the economy in Kyrgyzstan remains depressed and only a modest recovery is forecast for 1996 and 1997. Real household incomes are not expected to increase significantly during this period.

The bankers also cited the lack of a mortgage law as a principal impediment to development of the market. ICMA is working with the Council, the NBK and other USAID advisors on drafting a mortgage law for Kyrgyzstan. Other recommendations were to abolish or significantly reduce the property transfer tax and establish a system of property and lien registration to protect secured creditors. Several bankers indicated that their institutions would consider housing finance if the GOK took the actions necessary to make lending for housing a viable line of banking business.

Discussions with several bankers indicated that there would be interest in a housing and housing finance training program. Training will be important to the successful implementation of housing sector reform. In addition, the Kyrgyz participants in the recently completed ICMA housing finance training program could "team-teach" the courses with U.S. instructors. ICMA may want to consider offering a five course training program in Kyrgyzstan consisting of the following:

- a. Principles of Real Estate Finance and Investment
- b. Mortgage Lending
- c. Construction Lending
- d. Appraisal
- e. Condominium Formation and Management

#### D. CITY OF BISHKEK

The City of Bishkek has taken a leadership role in several areas, notably competitive auctions for government owned properties and participation in the establishment of a new bank. The city, through the office of Chief Architect Tolobay Keneshov, has held three successful sealed bid auctions of parcels of real estate owned by the city. Bishkek can serve as a model for local administrations throughout the country.

In addition to the disposition of property owned by the city, Chief Architect Keneshov's highest priorities are the development of the "zones of individual construction" and the provision of municipal services. City officials have recognized that financing is critical for the success of any programs they devise and are actively seeking sources of foreign and domestic investment. The City intends to participate in the United Nations Habitat conference to be held in Turkey in June, 1996, to promote foreign investment in the city. The city has also joined with other investors to establish a new bank - the Bishkek Bank. The bank was authorized by the NBK in October, 1995. The city has provided space for the bank's headquarters. One of the primary functions of Bishkek Bank will be to act as the fiscal agent for the city. The city will hold all of its deposits at the bank and will use the bank as its paying and transfer agent. All fees and other revenues collected by the city, including fees for public

utilities, will be paid into the bank. Bishkek Bank hopes to serve as the apex institution for programs and projects in the City of Bishkek.

**ANNEX A**  
**OBJECTIVES AND ORGANIZATION OF**  
**THE HOUSING POLICY REFORM PROJECT**